Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1978

No. Misc. 78-1105

NASSAR AND CO., INC. AND GEORGE M. NASSAR,
Petitioners,

v.

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, AND DAVID L. BAZELON, HAROLD LEVENTHAL AND SPOTTSWOOD W. ROBINSON, JUDGES OF SAID COURT,
Respondents.

MOTION FOR LEAVE TO FILE PETITION FOR WRIT OF MANDAMUS AND/OR PROHIBITION, PETITION FOR WRIT OF MANDAMUS AND/OR PROHIBITION, OR, IN THE ALTERNATIVE, MOTION FOR STAY OF AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION, AND BRIEF IN SUPPORT THEREOF.

CARL L. SHIPLEY
1108 National Press Building
Washington, D.C. 20045
(202) 783-1647

Of Counsel:

SHIPLEY SMOAK & AKERMAN
1108 National Press Building
Washington, D.C. 20045

THE CASILLAS PRESS, INC.—1717 K Street, N. W.—Washington, D. C.—223-1220

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UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, AND DAVID L. BAZELON, HAROLD LEVENTHAL AND SPOTTSWOOD W. ROBINSON, JUDGES OF SAID COURT,
Respondents.

MOTION FOR LEAVE TO FILE PETITION FOR WRIT OF MANDAMUS AND/OR PROHIBITION, OR, IN THE ALTERNATIVE MOTION FOR STAY

Petitioners Nassar and Co., Inc. and George M. Nassar move for leave to file their petition for a writ of mandamus and/or a writ of prohibition, or, in the alternative, motion for stay hereto annexed; and further move that an order and rule be entered and issued directing the United States Court of Appeals for the District of Columbia Circuit and the Honorable David L. Bazelon, Honorable Harold Leventhal and Honorable Spottswood W. Robinson of said court, to show cause why a writ of

mandamus and/or a writ of prohibition should not be issued against them in accordance with the prayer of said petition, and why petitioners should not have such other and further relief in the premises as may be just and meet.

Respectfully submitted,

CARL L. SHIPLEY
1108 National Press Building
Washington, D. C. 20045
(202) 783-1647

Of Counsel:

SHIPLEY SMOAK & AKERMAN
1108 National Press Building
Washington, D. C. 20045

TABLE OF CONTENTS

	Page
OPINIONS IN COURTS BELOW	2
JURISDICTION	3
QUESTION PRESENTED	3
STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED	3
STATEMENT OF THE CASE	3
STATEMENT OF REASONS WHY WRIT OF MANDAMUS AND/OR PROHIBITION SHOULD ISSUE	6
CONCLUSION	16

TABLE OF AUTHORITIES

Cases:

Associated Securities Corp. v. Securities and Exchange Commission, 283 F2d 773 (10th Cir. 1960)	8
Baird & Co., 43 SEC 815	11
Blyth & Co., 43 SEC 1015	11
Coleman v. Paccar, 424 U.S. 1301 (1976)	6, 7
D. H. Blair & Co., 44 SEC 320	11

Page

Dent v. West Virginia,
129 U.S. 114 (1889) 12

Dominick & Dominick,
38 SEC 843 11

Dow Theory Forecasts,
43 SEC 821 11

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976) 9

Kidder Peabody & Co.,
43 SEC 911 11

Laird, Bessell & Meeds,
44 SEC 45 11

Landis v. North American Co.,
299 U.S. 248 (1936) 6

Loeb, Rhoades & Co.,
44 SEC 202 11

Merrill, Lynch, Pierce, Fenner & Smith,
43 SEC 933 11

Meyer v. Nebraska,
262 U.S. 390 (1934) 12

Nassar and Co., Inc. v. Securities and Exchange Commission,
566 F2d 790 (D.C.Cir. 1977) 2, 5

Paine, Webber, Jackson & Curtis,
43 SEC 1042 11

Schware v. Board of Bar Examiners,
353 U.S. 232 (1957) 12

Page

Securities and Exchange Commission v. Blatt,
583 F2d 1325 (5th Cir. 1978) 8, 13, 14, 15

Securities and Exchange Commission v. Capital Gains Research Bureau,
306 F2d 606 (2d Cir. 1962) 14

Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc.,
574 F2d 90 (2d Cir. 1978) 14, 15

Steelman v. All Continent Corp.,
299 U.S. 248 (1936) 6

Shearson, Hamill & Co.,
42 SEC 811 11

Terrace v. Thompson,
262 U.S. 197 (1934) 12

Thompson & McKinon,
43 SEC 785 11

Statutes & Rules:

Constitution of the United States, Article V 3

United States Code:

5 USC 705 6
15 USC 77g(a) 4
15 USC 78j(b) 4
15 USC 78j(b)(1) 14
15 USC 78o 3
15 USC 78u 7
28 USC 1651 . . . . . 3, 6, 7

Code of Federal Regulations

17 CFR 240.10b-5 4

TABLE OF CONTENTS

APPENDICES

		Page
A	OPINION AND ORDER OF OCTOBER 3, 1977 U. S. COURT OF APPEALS, D. C.	1a
B	OPINION AND ORDER OF NOVEMBER 22, 1978 SECURITIES AND EXCHANGE COMMISSION . .	1b
C	ORDER OF DECEMBER 28, 1978, U. S. COURT OF APPEALS, D. C.	1c
D	ORDER OF JANUARY 5, 1979, U. S. COURT OF APPEALS, D. C.	1d

IN THE

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October Term, 1978

No. , Misc.

NASSAR AND CO., INC. AND GEORGE M. NASSAR,
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v.

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, AND DAVID L. BAZELON, HAROLD LEVENTHAL AND SPOTTSWOOD W. ROBINSON, JUDGES OF SAID COURT,
Respondents.

PETITION FOR A WRIT OF MANDAMUS AND/OR PROHIBITION TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, AND THE HONORABLE DAVID L. BAZELON, HONORABLE HAROLD LEVENTHAL AND HONORABLE SPOTTSWOOD W. ROBINSON, JUDGES OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, OR IN THE ALTERNATIVE, AN ORDER STAYING AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS IN COURTS BELOW

On October 3, 1977, the United States Court of Appeals for the District of Columbia Circuit granted petitioner's petition for review and vacated a February 12, 1976, Securities and Exchange Commission Order which revoked the securities broker and dealer registration of Nassar and Co., Inc., expelled the company from membership in the National Association of Securities Dealers, Inc., and barred George M. Nassar from association with any securities broker or dealer and remanded the case to the Securities and Exchange Commission for reconsideration in light of the Court's Opinion. *Nassar and Co., Inc. v. Securities and Exchange Commission*, 566 F.2d 790 (D.C. Cir. 1977) (Appendix A hereto.)

On November 22, 1978, subsequent to the remand proceedings ordered by the Court of Appeals, the Securities and Exchange Commission entered an order revoking the registration of Nassar and Co., Inc. as a broker and dealer, expelling the Company from membership in the National Association of Securities Dealers, Inc. and barring George M. Nassar from association with any broker or dealer with the provision that Mr. Nassar may apply to the Commission after two years from the date of the Order to become so associated. (Appendix B hereto.)

On December 28, 1978, respondents denied petitioners' motion for stay of the November 22, 1978 Order of the Securities and Exchange Commission (Appendix C hereto.)

On January 5, 1979, the United States Court of Appeals for the District of Columbia Circuit denied petitioners' petition for reconsideration of motion for stay of an order of the Securities and Exchange Commission..

JURISDICTION

This Court's jurisdiction is invoked under 28 USC §1651, on grounds the Court has potential jurisdiction in the action in which the writs are sought.

QUESTION PRESENTED

1. Whether the Court of Appeals for the District of Columbia Circuit abused its discretion or otherwise failed to exercise its jurisdiction in denying the motion of petitioners for stay of a Securities and Exchange Commission Order which barred petitioners from the securities industry.

STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED

1. Constitution of the United States, Article V, in pertinent part:

> "No person shall be . . . deprived of life, liberty or property without due process of law . . .".

STATEMENT OF CASE

Petitioner Nassar and Co., Inc. is a small securities brokerage firm registered as such with the Securities and Exchange Commission pursuant to 15 USC §78o. Petitioner George M. Nassar is the founder and president of Nassar and Co., Inc.

Petitioners come to this Court seeking a writ of mandamus directing the United States Court of Appeals for the District of Columbia Circuit to vacate its December 28, 1978 Order denying petitioners' motion to stay the

November 22, 1978 Order of the Commission imposing the extreme sanctions set forth hereinabove and enter an order granting said motion for stay. The facts giving rise to the November 22, 1978 Commission Order are set forth hereinbelow.

After a hearing before a Commission Administrative Law Judge petitioners were found to have violated the anti-fraud provisions of the Securities Act of 1933, 15 USC §77g(a), the Securities Exchange Act of 1934, 15 USC §78j(b), and Commission Rule 10b-5 thereunder, 17 CFR §240.10b-5, in connection with the sale of stock of Interamerican Ltd., a company whose shares were listed on the Calgary Stock Exchange and continuously traded by more than 100 brokers in the United States.

Petitioner Nassar's allegedly unlawful activities occurred during the period April 1, 1966 to May 18, 1967, and involved his statements to customers of his brokerage firm who made unsolicited purchases of Interamerican stock. Nassar's brokerage firm is not an issuer or dealer, and petitioner never carried an inventory or bought or sold for his own account. Petitioner's firm acted only as a broker and charged a regular commission on the sale of Interamerican securities between other buyers and sellers in the secondary market.

Basically, the Commission found that petitioner's representations concerning the stock were unduly optimistic, lacked an adequate basis in fact, and were made on the basis of an inadequate investigation. Additionally, petitioner was found to have made unwarranted predictions concerning the price to which the stock might rise. The Commission did *not* find, however, that petitioner was as culpable as other parties involved in the sale of the stock. In fact, the Commission accepted as true petitioner's claim

that he himself had been deceived by representations made to him by other parties. Indeed Mr. Nassar sustained heavy losses on purchases of Interamerican stock he had made for himself and which he holds to this day.

Except for the allegedly unlawful conduct occurring in 1966 and early 1967, petitioner has operated his securities business under the constant surveillance of the Securities and Exchange Commission, the Philadelphia Stock Exchange and the National Association of Securities Dealers, Inc., without a single instance of misconduct. Such an exemplary record spans a period of almost ten years, ending, of course, with the Commission Order of February 12, 1976, revoking the company's registration.

Subsequent to the Court of Appeals Order in *Nassar and Co., Inc. v. Securities and Exchange Commission*, 566 F.2d 790 (D.C. Cir., Oct. 3, 1977), vacating the Commission's February 12, 1976 Order, petitioner invested large sums of money in restarting his business, employing personnel, leasing space, leasing various types of office machines and computer terminals which are necessary in carrying on the business of securities broker and dealer, securing the necessary bonds, and meeting all other lawful requirements necessary to engage in the securities business.

The Commission's order of November 22, 1978, has once again put petitioner out of business. In an effort to save their economic lives, petitioners moved in the Court of Appeals for a stay of the Commission Order pending judicial review. Petitioners' motion for stay was denied by the Court of Appeals on December 28, 1978, and petitioners' petition for reconsideration of its motion for stay was denied January 5, 1979. Petitioners now come to this Court seeking relief which justice and equity require.

STATEMENT OF REASONS WHY WRIT OF MANDAMUS AND/OR PROHIBITION SHOULD ISSUE

The All Writs Act, 28 USC § 1651, was intended by Congress to be used by this Court in exercising its power of supervision over the Courts of Appeals. Justice Cardozo has said:

> "The power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants."

Landis v. North American Co., 299 U.S. 248 (1936).

In *Steelman v. All Continent Corp.*, 301 U.S. 278 (1937), Justice Cardozo said the all writs law, now 28 USC § 1651, is a source of power for a federal court to stay a proceeding. Justice Rehinquist, in *Coleman v. Pascar, Inc.*, 424 U.S. 1301 (1976), determined that a stay is equivalent to a preliminary injunction and that an application for either must be judged by the same standards. *Id.* at 1305. Congress has established such a standard in the Administrative Procedure Act:

> "On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, *including the court to which a case may be taken on appeal from or on application for certiorari* or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings." (emph. supp.) 5 USC § 705.

The above statute clearly indicates that this Court has not only the power under 28 USC § 1651 to review the Court of Appeals denial of a stay, but also has the authority to protect petitioners from "irreparable injury" and to preserve the status and rights of the parties involved pending review.

What standards should apply? This Court can judicially notice that without postponement of the effective date of the SEC order, petitioners are out of business. Even should they ultimately prevail, it will be an empty victory because their customers will have gone to competitors, their overhead costs – such as leasing of office space, rental of computer terminals and office equipment – will have been wasted; their capital will be exhausted, their employees and experienced salesmen will have relocated with competitors –clearly a blueprint for economic disaster.

Will the public interest be adversely affected? No – because Nassar must conduct his business under the continuous surveillance of the SEC, the NASD and the Philadelphia Stock Exchange – all regulatory agencies established by Congress to protect the public interest. If Nassar errs, the SEC can have the stay vacated (*see, e.g., Coleman v. Paccar*, 424 U.S. 1301 (1976)), or seek an injunction in the District Court forthwith. Under Section 21 of the Securities Exchange Act of 1934 (15 USC § 78u), the Commission has the power and the duty to seek an injunction if "it shall appear" that any person "is about to engage" in acts or practices constituting a violation of the Act or any SEC rule. That it has not asked a U. S. District Court to act raises a presumption that the Commission has no evidence of any "reasonable likelihood" of future violations by Nassar. The undisputed fact that petitioners were permitted by the SEC to continue in business from 1967 to 1976 is substantial evidence of no "reason-

able likelihood" of future violations (*see, e.g., Securities and Exchange Commission v. Blatt*, 583 F.2d 1325 (5th Cir. 1978).

Petitioners are aware that there are numerous judicial decisions by lower courts rationalizing away the right to protection pending an Article III review, *e.g., Associated Securities Corp. v. SEC*, 283 F.2d 773 (10th Cir. 1960), but urge that it is time for this Court to restore fair play to this type of SEC proceeding. This case does not involve theft, embezzlement, fraud, deceit, or other types of violative conduct often present in SEC cases. Nassar is a small business broker who, purely on a commission basis as an agent, filled unsolicited orders of his customers for stock of Interamerican Industries, Ltd., a stock in which he had first personally invested in heavily and which was being traded by more than 100 brokers, including New York Stock Exchange members, all in reliance on reports and other "due diligence" sources, such as interviews with management and company personnel, which in the end turned out to be largely false. Nassar did not lie or falsify, or misrepresent facts to his customers – the record shows he told them exactly what he honestly believed, based on his own investment judgment and advice, which was the basis for his own and his family's investment in the stock.

Interamerican introduced a new product – a delayed action birth control pill protected by a United States patent, at a time when the United Nations and other agencies were deeply concerned with the population explosion in the world. At this time there was widespread publicity in the news media. India and other developing nations were being urged to undertake birth control programs. Enormous amounts of U.S. taxpayer's money was being expended by our government to stimulate

family planning and birth control. Syntex, a U. S. company first in the field with a birth control pill, had a spectacular rise on the New York Stock Exchange from a few dollars a share to over $60 a share. The record before the SEC is replete with this evidence. That record has never been before the Court of Appeals. Although Section 25 of the 1934 Act refers to "filing of the record" on review, the SEC customarily files a "summary" of the record. In this case, the lower court has never seen the record, although it has an obligation to review the record for "substantial evidence".

The facts of this case are exceptional. Petitioner Nassar, himself a victim of a fraud, is barred from the securities industry because he expressed to his customers his own *bona fide* belief in a stock he had purchased in large amounts for his own account – stock which he owns today. There was no "scienter" (see *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976)), he was not an issuer, there was no insider trading, no breach of fiduciary duty. There was negligence, there was lack of adequate basis for recommending the stock, there was overly optimistic analysis. But is this not the case for every investor who purchases stock from his friendly neighborhood broker in reliance on his broker's judgment that the stock will go up? Do not the members of this Court read every day in the financial pages various ads about which stock will split, go up, increase a dividend, *etc.*? Has any member of this Court in private life ever purchased a share of stock from his broker without having been told it will in all probability increase in value – and then watched it sink in a down market, blue chips and all?

This Court can take judicial notice of facts in the SEC's annual reports to Congress – there are nearly 3,000 stock issues listed on stock exchanges, with a value of over $1

trillion. The volume of stocks traded each year on registered stock exchanges is $170 billion. There are approximately 5,000 brokers registered with the SEC, with some 16,000 employees. Their total annual revenue is over $7.3 billion, with a collective pre-tax profit of about $1 billion or 15%, of which about one half is derived from securities commissions. These figures do not include the vast over-the-counter market where even more stocks are traded, largely on a dealer basis.

This Court can take notice of the fact that the Dow Jones industrial average has fluctuated from 46 to over 1,000 in the last 40 years – vast fortunes have been made, lost, retrieved, lost again, in eras of speculation, depression, recession, inflation, war, peace, prosperity, *etc.* And in all these vicissitudes some 5,000 brokers plus about 4,000 registered investment advisers have given their customers opinions and advice as to when to buy, sell, hold – and very often that advice has been disastrously wrong. Some of it was based on inadequate investigation, overly optimistic estimates, overly enthusiastic endorsements – it would fly in the face of common sense to suppose all these billions of securities commissions paid to brokers were because the investors "bought" rather than being "sold". And who ever bought a stock from a broker who gave a negative sales talk – or who did not make some appeal to the human hope for gain and profit? No one.

Over 90% of all stocks traded are on the national exchanges. Yet has the SEC ever found occasion in its 44 years of existence to bar a major NYSE firm permanently from the securities industry? Petitioners have not been able to find such a case. However, the records are full of the Commission's kid-glove, do-not-rock-the-boat approach to enforcement where the dominant firms are

involved. The record shows a glaring example of selective enforcement by the SEC, with light sanctions for big, well known firms, and death sentences for small business firms. The SEC on its own record stands convicted of unequal protection of the law in violation of the Fifth Amendment. The Court can notice such SEC cases as:

Baird & Co., 43 SEC 815;
Blyth & Co., 43 SEC 1015;
Dow Theory Forecasts, 43 SEC 821;
Kidder, Peabody & Co., 43 SEC 911;
Merrill, Lynch, Pierce, Fenner & Smith, 43 SEC 933;
Paine, Webber, Jackson & Curtis, 43 SEC 1042;
Thomson & McKinnon, 43 SEC 785;
Walston & Co., Inc., 43 SEC 508;
D. N. Blair & Co., 44 SEC 320;
Loeb, Rhoades & Co., 44 SEC 202;
Laird, Bessell & Meeds, 44 SEC 45;
Shearson, Hamill & Co., 42 SEC 811;
Dominick & Dominick, 38 SEC 843.

These are just random cases hastily plucked from SEC reports – but they all have one thing in common – egregious violations much worse than Nassar's and a tap-on-the-wrist remedial sanction. Each firm is or was at the time a big name in Wall Street. None was barred from the industry or even suspended.

Petitioners are preparing an application to the court below "for leave to adduce additional evidence" as permitted under Section 25(a)(5) of the 1934 Act, so that the case can be remanded to the Commission and petitioners can show there is no "reasonable likelihood" of their committing future violations, and that the extreme sanction imposed on petitioners is in violation of their constitutional right to equal protection of the laws, and that the sanc-

tion imposed on petitioners is a penal sanction and not a remedial sanction and is in excess of the SEC's statutory jurisdiction. However, if petitioners get no stay, they are out of business and will have no income with which to prosecute their right to judicial review.

Petitioner Nassar's right to engage in the securities business is constitutionally protected. Like any other citizen, the Constitution protects his "right to earn a livelihood by following the ordinary occupations of live." *Terrace v. Thompson*, 262 U.S. 197 (1934); *Meyer v. Nebraska*, 262 U.S. 390 (1934).

This Court has held that the right to hold specific private employment and to follow a chosen profession free from unreasonable governmental interference comes within the "liberty and property" concepts of the Fifth Amendment, "property" being the employment, and "liberty" being the freedom to practice a chosen profession. *Dent v. West Virginia*, 129 U.S. 114 (1889); *Schware v. Board of Bar Examiners*, 353 U.S. 232 (1957).

Unless this Court orders respondents to stay the SEC's Order at issue here, petitioners will effectively be barred from earning a livelihood and will suffer irreparable harm as the result of unreasonable government action on behalf of the SEC in imposing the excessive penal sanctions involved herein. Without a stay of the Commission's Order, Nassar is, in reality, denied any meaningful judicial review. This Court can judicially notice the impracticality of stop and go operation occasioned by SEC orders closing a small business securities broker. The practical effect of denial of a stay in this case is to deprive petitioners of their constitutional right to the effective assistance of counsel, and to their right to have an Article III court review the Commission's administrative record to see whether or not (1) there

is substantial evidence to support the Commission's action, (2) whether the sanction imposed is punitive and not justified in terms of investor protection, and (3) whether the Commission made any findings that, despite 10 years of post-violative exemplary conduct with full SEC approval, there is "a reasonable likelihood of future violations." See *Securities and Exchange Commission v. Blatt*, 583 F.2d 1329 (5th Cir. 1978).

Absent a stay in this case, judicial review for petitioners is no more than a hollow shell since the remedy requested – vacation of the Commission order imposing the sanctions – will be too little too late. Petitioners will have been effectively put out of business *before* having an Article III fair trial.

Subsequent to the Court of Appeals Order vacating the Commission's February 12, 1976 Order, petitioner invested large sums of money in getting his business started up again (Statement of Case, *supra* at 5.) which, but for the SEC's unlawful order of February 12, 1976, he would have been able to continue without such tremendous expense. Petitioners have been damaged almost irretrievably, not only because of the stigma of widespread publicity that his license had been revoked for violation of the antifraud provisions of the federal securities laws, but by the mere fact that his doors had been closed.

The Court of Appeals December 28, 1978 Order has again put Mr. Nassar out of business just as effectively as if the Commission's decision was final and not subject to judicial review. Practically, petitioner cannot stop and start going into business, not only as a matter of cost, but as a matter of practical relationship with his customers in his market area.

The denial of a stay in this instance is, for all practical purposes, an economic death sentence.

Unless the Commission's November 22, 1978 Order is stayed, petitioners will be barred from earning a livelihood. The effect of such a bar is the same as a permanent injunction which should not be granted when the administrative record is totally devoid of any evidence of possible future violative conduct. (See Statement of Case.)

In a recent case in the Fifth Circuit, *Securities and Exchange Commission v. Blatt*, 583 F.2d 1325 (Nov. 15, 1978), the Court had occasion to analyze the standards applicable to the Commission's issuance of permanent injunctions under Section 10(b) of the Securities Exchange Act of 1934. 15 USC §78j(b)1. Since the effect of a permanent injunction and an order revoking registration and imposing a bar from association with any broker or dealer is the same, the standards applicable to such orders and considerations inherent therein should likewise be the same. The Court in *Blatt* noted, "that the seriousness of permanent injunctions recently has triggered closer appellate scrutiny of SEC injunctions than was found in earlier decisions." *Id.* at 1334. In *SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90 (2d Cir. 1978), Judge Friendly observed that:

> "(i)t is fair to say that the current judicial attitude toward the issuance of injunctions on the basis of past violations at the SEC's request has become more circumspect than in earlier days. Experience has shown that an injunction, while not always a 'drastic remedy' as appellants contend, often is much more than the 'mild Prophylactic' described . . . in *SEC v. Capital Gains Research Bureau, Inc.*, 306 F.2d 606, 613 (2d Cir. 1962) . . ."

Id. at 99.

The stay at issue here, like the injunction at issue in *Blatt* and *Capital Gains* is, to a great extent, dependent upon balancing the petitioner's past conduct against any reasonable likelihood of future violations.

> "The critical question in issuing the injunction and also the ultimate test on review is whether defendant's past conduct indicates that there is a *reasonable likelihood of further violations in the future.* To obtain injunctive relief the Commission *must offer positive proof* of the likelihood that the wrongdoing will recur. *SEC v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 99-100 (2d Cir. 1978). The Commission needs to go beyond the mere fact of past violation. *Id.*"

SEC v. Blatt, 583 F.2d 1325 at 1334. (emph. supp.)

In the Nassar case, the Commission relies *entirely* upon the fact of a past violation occurring in 1966-67, and nothing else. In reversing in the *Blatt* case, the Court of Appeals said, "We find that the Commission failed to demonstrate a reasonable likelihood of future violation", as justifying the sanction of an injunction. *Id.* at 1327. Petitioner submits that the Commission has failed to demonstrate any reasonable likelihood of future violation by Nasser. Petitioners have a perfect record of compliance with SEC rules and the federal securities laws in the 12 years since the single violation in 1966. The prospect of Mr. Nassar's future honesty is not in question. It is a demonstrated fact.

In light of these considerations and in the balance of the equities herein involved, petitioners submit that respondents have grossly abused their discretion and have so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

CONCLUSION

WHEREFORE, petitioners pray:

1. That a writ of mandamus and/or prohibition issue from this Court directed to respondents requiring them to show cause on a day to be fixed by this Court why mandamus and/or prohibition should not issue from this Court directing respondents to vacate their said Order of December 28, 1978, and in lieu thereof issue an order granting petitioners' motion for stay filed with the Court in D. C. Court of Appeals No. 78-2239; or

2. That this Court grant a stay of the Securities and Exchange Commission's November 22, 1978 order; and

3. That petitioner have such additional relief and process as may be necessary and appropriate in the premises.

Respectfully submitted,

CARL L. SHIPLEY
1108 National Press Building
Washington, D. C. 20045
(202) 783-1647

Of Counsel:

SHIPLEY SMOAK & AKERMAN
1108 National Press Building
Washington, D. C. 20045

APPENDIX A

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 76-1278

NASSAR AND COMPANY, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

Petition for Review of an Order of the Securities and Exchange Commission

---

No. 76-1536

NASSAR AND COMPANY, INC., AND GEORGE M. NASSAR, APPELLANTS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

Appeal from the United States District Court
for the District of Columbia

(D.C. Civil 76-339)

Argued May 5, 1977

Decided October 3, 1977

Carl L. Shipley for petitioners in No. 76-1278 and appellants in No. 76-1536.

David Ferber, Solicitor, Securities and Exchange Commission, with whom *Alan Rosenblat*, Assistant General Counsel and *Howard B. Scherer*, Attorney, Securities and Exchange Commission, were on the brief, for respondent in No. 76-1278 and appellee in No. 76-1536.

Before: BAZELON, *Chief Judge*, LEVENTHAL AND ROBINSON, *Circuit Judges*

Opinion for the Court filed by *Chief Judge* BAZELON.

Concurring opinion filed by *Circuit Judge* LEVENTHAL.

BAZELON, *Chief Judge*: Both of these related cases involve an order of the Securities and Exchange Commission, entered February 12, 1976, which revoked the registration of Nassar, Inc. as a broker and dealer in securities, expelled it from membership in the National Association of Securities Dealers, Inc. and barred Mr. Nassar from association with any broker or dealer.[1] No. 76-1278 is before us on a petition to review the Commission's order pursuant to Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y(a).[2] In No. 76-1536, Nassar appeals from a district court order dismissing for lack of jurisdiction his action which sought to have the Commission's order declared null and void. Apart from the jurisdictional issue raised by the second case,[3] the issues in the two cases are virtually identical. For the reasons expressed below, we vacate the Commission's order and remand for further consideration.

After a consolidated hearing involving several parties,[4]

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[1] Nassar, Inc. and Mr. Nassar will be referred to either as "petitioner" or "Nassar." The Commission's order has not been published.

[2] That section states,

> A person aggrieved by a final order of the Commission entered pursuant to this title may obtain review of the order in the United States Court of Appeals for the . . . District of Columbia Circuit. . . .

[3] Nassar recognizes that a petition for review in the Court of Appeals is a proper means for obtaining review of the Commission's order. Nevertheless, he argues that in this case the Administrative Procedure Act also authorizes review in the district court by declaratory judgment. This argument is wholly without merit. Section 703 of the APA, 5 U.S.C. § 703, provides that,

> The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action. . . .

As noted above, § 25(a) of the Securities Exchange Act provides for review of Commission orders in the Court of Appeals. Since that section also provides that such relief is exclusive, § 25(a)(3), and Nassar has not shown it to be inadequate in any way, the district court was correct in dismissing the declaratory action for lack of subject matter jurisdiction. *See generally*, Investment Company Institute v. Board of Governors of the Federal Reserve System, 551 F.2d 1270 (D.C. Cir. 1977).

[4] Nassar argues that his due process rights were infringed by having his case consolidated with others. However, "[n]o principle of administrative law is more firmly established than that of agency control of its own calender." Association

the administrative law judge found that petitioner and the others had "willfully" violated the antifraud provisions of the securities acts in connection with the sale of stock of Interamerican Ltd.[5] On review, the Commission affirmed the ALJ's finding that petitioner had violated these provisions by his participation in a "massive fraud" designed by Interamerican's promoter, Hausner. Hausner inflated the price of Interamerican stock by spreading the spurious claim that the company was ready to market an effective oral contraceptive whose "sustained release" feature made it suitable for sale in underdeveloped countries. In furtherance of this scheme, Hausner took pains to convince Nassar of the efficacy and potential profitability of this product.

Nassar's allegedly unlawful activities occurred in his efforts to sell Interamerican stock to customers of his brokerage firm. Essentially, the Commission found that Nassar's representations concerning the stock were unduly optimistic, lacked an adequate basis in fact, and were made on the basis of a wholly inadequate investigation. In addition, he was found to have made unwarranted predictions about the price to which the stock might rise. The Commission did not find, however, that

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of Massachusetts Consumers, Inc. v. S.E.C., 516 F.2d 711, 714 (D.C.Cir. 1975). Of course, an agency does not have unlimited discretion to consolidate cases. *Id.* But petitioner has shown no prejudice from the Commission's decision to consider his case along with those of others involved in the alleged fraud. The Commission carefully distinguished every aspect of its decision regarding Nassar—evidence, violation and sanction—from those of the other parties. Nassar's other contentions regarding the fairness of his hearing are equally meritless.

[5] Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); and Commission Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

Nassar was as culpable as Hausner. Indeed, "[f]or present purposes" the Commisison accepted as true Nassar's claim that he himself had been deceived by Hausner's representations and had sustained heavy losses on purchases of Interamerican stock. J.A. 8.

After summarizing Nassar's activities, the Commission found that he had "willfully" violated § 10(b) of the Exchange Act, Commission Rule 10b-5 implementing that section, and § 17(a) of the Securities Act. However, the Commission did not explain which activities violated which provision, or whether all of the activities violated both acts. Moreover, the Commission made no findings regarding Nassar's scienter; indeed, the order contains no discussion of the mental state required to make out violations of these provisions. The Commission did refer to Nassar's violation as being "willful" and his price quotations as being "reckless," J.A. 16, but it failed to explain if it was using these terms in a technical or a descriptive sense. Similarly, the reasons for affirming the suspension of Nassar were not explained in detail, the Commission merely noting:

> [W]e are unable to take a sanguine view as to the prospect of Nassar's future honesty. To permit one so prone to irrational euphoria and blatant exaggeration to continue to meddle with other people's money would be contrary to the public interest. J.A. 22.

These cases ensued. While review was pending, the Supreme Court issued its decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). The Court held that a private action for damages will not lie under § 10(b) of the Exchange Act and Commission Rule 10b-5 in the absence of any allegation of "scienter," which it referred to as intent to deceive, manipulate or defraud. 425 U.S. at 193.

The only substantive issue presented is whether, after *Hochfelder*, some form of scienter must be established in an administrative enforcement proceeding under § 10(b) and Rule 10b-5 as well as in a private action.[6] Another panel of this court recently addressed this question and concluded that it should be resolved in the first instance by the Commission itself:

> The applicability of the *Hochfelder* decision to enforcement actions brought by the SEC is a question that has not been decided by this court. In addition, we have before us only the views of the attorneys representing the Commisison, and not the Commission itself, as to the applicability of the *Hochfelder* scienter requirement in actions of this type. We emphasize that we intimate no view as to the applicability of the *Hochfelder* scienter requirement to this case. We hold only that the actions of the petitioners must be re-evaluated in light of significant Supreme Court precedents [7] rendered since petitioners' case was decided by the Commission.

Collins Securities Corp. v. SEC, No. 75-2200, slip op. at 13-14 (D.C.Cir., August 12, 1977). In deference to *Collins Securities*, therefore, we also remand this case to the Commisison for reconsideration in light of *Hochfelder*.

The Commission attempts to distinguish *Hochfelder* on the ground that the case under review involves a violation of § 17(a). In *Hochfelder*, the Court recognized

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[6] Nassar also raises a spate of constitutional issues. Though we need not reach these issues because of our disposition of this case, we note that they appear meritless. Nor need we decide whether the Commission's order was supported by substantial evidence.

[7] In addition to *Hochfelder*, *Collins Securities* also referred to the Supreme Court's recent decision in Santa Fe Industries, Inc. v. Green, 97 S.Ct. 1292 (1977).

that on its face Rule 10b-5 covered behavior in which scienter was absent. Since the language of § 17(a) is virtually the same as that of Rule 10b-5,[8] the Commission reasons that an action under § 17(a) will lie even in the absence of an allegation of scienter. Hence, the Commission regards § 17(a) as adequate support for

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[8] Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 17(a) provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

its order. However, the Commission's order neither indicates which behavior violated § 17(a) nor whether violations of § 17(a) alone would have sufficed to support Nassar's suspension. Although on remand the Commission may rest on § 17(a) alone, "[the] administrative order [now under review] can be affirmed on appeal only on the grounds on which the Commission relied." *KIRO v. FCC*, 545 F.2d 204, 208 (D.C.Cir. 1976). Because the Commission's discussion of § 17(a) is not separate from its discussion of § 10(b), we cannot affirm its result on the basis of § 17(a) alone.

Conclusion

We vacate the Commission's order and remand the case to the Commission for reconsideration in light of this opinion and such further proceedings, if any, it deems appropriate. In connection with the remand, we note that Nassar maintains that the sanction ordered by the Commission is overly severe and hence arbitrary. We need not reach this issue at this time, since on remand the Commission may find no violation or may decide to impose a lesser sanction. However, should the Commission seek to reinstate this penalty it should articulate its reasons for doing so with greater particularity. The discussion in the order is simply too brief to enable this court to determine if the sanction ordered was based on a consideration of all the relevant factors and is in accord with Commission precedent.

> ***The order of the district court in No. 76-1536 is affirmed. The petition for review in No. 76-1278 is granted and that case is remanded to the Commission for further consideration not inconsistent with this opinion.***

LEVENTHAL, *Circuit Judge, concurring*: The SEC decision revoking Nassar's registration issued prior to *Ernst*.[1] This court remands for reconsideration in the light of *Ernst*. I agree.

The pertinent consideration is not unrelated to the ruling in *Collins Securities Corp. v. SEC*, No. 75-2200 (D.C. Cir., Aug. 12, 1977), that an order revoking such registration must be based on "clear and convincing evidence." While that question is not involved in this case,[2] it identifies the care needed as a condition for revocation.

Even assuming that a scienter is needed for revocation of registration, that does not mean that what is required is the kind of subjective deceit that *Ernst* held to be required in an action for damages. As the Commission points out, a broker-dealer may be guilty of intentional misconduct if he deliberately commits certain acts even if he doesn't know they are forbidden by the Act or regulations. In other words, there is no requirement of specific intent that includes a specific element of knowledge of the pertinent rule of law.[3] A broker-dealer is under an obligation to learn the rule of law.

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[1] Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

[2] The SEC did state in fn. 68 (J.A. 132), see note 4 of this opinion, *infra*, that this proceeding is governed by the standard of preponderance of evidence. However, it also stated that in any event there was clear and convincing evidence. On remand, it should apply the clear-and-convincing standard.

[3] Scienter does not mean specific intent in the sense of knowing that the conduct is prohibited by law:

> It has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

Gearhart & Otis v. SEC, 121 U.S.App.D.C. 186, 191, 348 F.2d 798, 802 (1965) (citation omitted).

A difficult question is raised by the statement in the Commission's opinion that Nassar was engaged in grossly reckless conduct[4] and in failure to do any reasonable checking of assertions made to him by Hausner (J.A. 120).

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[4] The only evaluation directed by the SEC specifically to petitioners' case consisted of the following:

> Nassar's case is by no means on all fours with Spangler's. There are distinctions.[68] Nassar did not have some of the warnings that Spangler had. Nor does he have Spangler's prior history of misconduct.
>
> But these distinctions are outweighed by the similarities between the two cases. Like Spangler, Nassar was wholly indifferent to the boundaries that separate fact from fiction, naively credulous, and prone to embroider on the falsehoods with which Hausner fed him. In Nassar's case, as in Spangler's, we deal with a high-pressure sales effort that lasted for a long time, was unsupported by any semblance of an adequate foundation, and was characterized by grossly reckless price predictions.
>
> Hence we are unable to take a sanguine view as to the prospect of Nassar's future honesty. To permit one so prone to irrational euphoria and blatant exaggeration to continue to meddle with other people's money would be contrary to the public interest. Like the administrative judge, we conclude that Nassar and his firm must be excluded from the securities business.

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[68] But the case against the Nassar respondents has been well established by "the reliable, probative, and substantial evidence" that the Administrative Procedure Act requires. 5 U.S.C. § 556(d). They say that this evidence is not "clear and convincing." We think it is. But the important thing is that the "clear and convincing" standard is inapplicable. A preponderance of the evidence is sufficient. See *M. V. Gray Investments, Inc.*, 44 S.E.C. 567, 575 (1971); *Norman Pollisky*, 43 S.E.C. 852, 861 (1968).

SEC Opinion in Proceeding 3-1950 at 22 (Feb. 12, 1976), J.A. 132 (footnotes other than No. 68 omitted).

Hanley v. SEC, 415 F.2d 589 (2d Cir. 1969), develops that standards for a securities dealer are strict, because, *inter alia*, "he implicitly represents that he has an adequate basis for the opinion he renders" and "[b]y his recommendation he implies that a reasonable investigation has been made. . . ." *Id.* at 596-97. *See also Hiller v. SEC*, 429 F.2d 856 (2d Cir. 1970).

In *Ernst*, the court explicitly refrained from deciding whether recklessness might be a basis of scienter for a damages action. 425 U.S. at 194 n.12. However, when we come to the SEC's control over the broker-dealers, we are dealing with a group that is under intense regulatory control and scrutiny. The Commission serves an important public interest in imposing and monitoring its controls. This function often involves evidence that requires sophisticated and sensitive appraisal. As we pointed out in *Collins Securities, supra*, in explaining why we refrained from the requirement used in deportation cases that the evidence be "unequivocal"—

> In the present case we have an administrative agency with a charter for protection of the public, and the function of evaluating with sophisticated sensitivity the conduct of those operating in a regulated industry. Two elements appear relevant to the standard we should impose here: (1) the type case (fraud); (2) the heavy sanction (deprivation of livelihood). Given those elements, typical of many SEC cases, and given the type of circumstantial proof on which the SEC most often must rely, it appears to us that the "clear and convincing evidence" standard is the proper standard here; it will require the SEC to reach a degree of persuasion much higher than "mere preponderance of the evidence," but still somewhat less than "clear, unequivocal and convincing" or "beyond a reasonable doubt." We think that the insertion of the word "unequivocal," used by the Supreme Court in deportation-type cases,

> would require the SEC to meet a standard of proof in alleged market fraud cases which, given the circumstantial nature of the proof almost inevitably necessarily relied upon, would cause the regulatory agency to fail in its proof in any except the most exceptionally blatant case.[5]

It may be that the SEC will conclude that scienter for purposes of this kind of discipline must include intentional violation of a duty specifically imposed by a Commission rule or regulation, and also, and perhaps necessarily, include conduct amounting to gross recklessness when the Commission has imposed a duty to make a careful check.

The agency's power to cope with broker-dealer recklessness can be expressed in terms of fraud,[6] and even formally structured in fraud on the ground that the broker-dealer makes an implied representation that he has checked,[7] which would be false if indeed he has not. But that is not a wholly satisfactory analysis, although it has been used in some instances, for I would suppose that the Commission has the power to discipline a broker-dealer who has not checked as required, even though misrepresentation might be negatived by advising his customers that he has not checked.

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[5] Collins Security Corp. v. SEC, No. 75-2200, slip. op. at 9 (D.C. Cir. Aug. 12, 1977).

[6] Counsel for the Commission puts this cast on the matter, invoking the SEC doctrine that predictions of a specific and substantial increase in price of a speculative security within a short time are "inherently fraudulent and cannot be justified." SEC Br. at 15-16, citing SEC opinions. The SEC considers this to be "a hallmark of fraud," Alexander Reid & Co., Inc., 40 S.E.C. 986, 991 (1962). The Sixth Circuit has said that such representations bear "the badge or mark of fraud." Henderson v. United States, 202 F.2d 400, 404 (6th Cir. 1953).

[7] Hanly v. SEC, 415 F.2d 589, 596-97 (2d Cir. 1969).

The law embraces a finding of fault in omissions, as in failure to perform a duty, and in failure to make a statement where silence is tantamount to concealment.

The concept that recklessness may serve as a surrogate for subjective intent is not new to the law. Indeed even for purposes of defining murder, recklessness may take the place of subjective intent.[8]

The fact that a further reflection and refinement is called for at this time should not set the Commission back in its objective of furthering the public interest. This is likely an instance where more ground may be covered with a slow start. While the Commission may resist many efforts to clasp *Ernst*, it can not free itself completely of the Court's concerns. Refinement of doctrine is not a scruple, it is a necessity. Set in sound perspective, however, *Ernst* should not impede the Commission's efforts to protect the public.

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[8] United States v. Dixon, 135 U.S.App.D.C. 401, 404-05, 419 F.2d 288, 291-92 (1969) (Leventhal, J., concurring).

APPENDIX B

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 15347 / November 22, 1978

Admin. Proc. File Nos. 3-1951 and 3-1952

In the Matter of

NASSAR AND COMPANY, INC.
301 Fifth Avenue Building
Pittsburgh, Pennsylvania
(8-12746)

GEORGE M. NASSAR

OPINION PURSUANT TO REMAND

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Fraud in Offer and Sale of Securities

Where registered broker-dealer and its president made false and misleading representations and predictions to customers concerning the testing, efficacy, production and sales of issuer's drug product, and prospective rises in the market price of issuer's stock, *held*, in public interest to revoke broker-dealer's registration, expel it from membership in registered securities

association, and bar its president from association with any broker or dealer with the proviso that, after two years, president may apply for permission to become so associated.

Scienter

Scienter requirement of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), *held* inapplicable to administrative proceedings initiated by Commission, although satisfied in this instance by reckless misconduct on the part of respondents. In any event, all of Commission's findings of fraud against respondents also made under Section 17(a) of the Securities Act to which *Hochfelder* is inapplicable.

APPEARANCES:

Carl L. Shipley, of Shipley, Smoak & Akerman, for respondents.

Paul F. Leonard, James C. Kennedy, John L. Hunter, Michael A. Starr and *Therese L. Miller*, for the Commission's Division of Enforcement..

I.

On February 12, 1976, we issued an order revoking the broker-dealer registration of Nassar and Company, Inc. ("registrant"), expelling the firm from membership in the National Association of Securities Dealers, Inc. ("NASD"), and barring George M. Nassar ("Nassar"), registrant's president and sole stockholder, from association with any broker or dealer.[1] Respondents appealed our decision to

[1] *Richard C. Spangler, Inc., et al.*, Securities Exchange Act Release No. 12104, 8 SEC Docket 1257.

the United States Court of Appeals for the District of Columbia Circuit. While the appeal was pending, the United States Supreme Court issued its decision in *Ernst & Ernst v. Hochfelder*.[2] Thereafter, the Court of Appeals vacated our order and remanded this case for reconsideration in the light of *Hochfelder* and with respect to certain other matters.[3]

On November 2, 1977, we issued an order inviting the parties to file briefs on the issues raised by the Court of Appeals.[4] Briefs were filed by respondents and by our staff, and we heard oral argument.

We turn first to a consideration of the facts in this matter.

II.

During the period from April 1966 to May 1967, respondents made false and misleading representations in connection with the offer and sale of stock of Interamerican Industries, Ltd., a Canadian company which had nothing but inactive mining and lumber interests and an inadequately tested and commercially untried birth controll pill. The distinctive attribute of Interamerican's pill was supposedly a "sustained release" feature capable of reducing adverse side effects.

The record shows that respondents engaged in a high pressure sales campaign characterized by wholly unwarranted price predictions and by representations that were unsup-

[2] 425 U.S. 185 (1976).

[3] 566 F.2d 790 (1977).

[4] Securities Exchange Act Release No. 14127, 13 SEC Docket 542.

ported by any semblance of an adequate foundation. Thus, Nassar advised customers that he had "a very hot item"; that buying Interamerican stock would make the purchaser "a millionaire"; that the stock, which was offered at prices ranging from about $2 to $20, would go to $100; and that "if it continues to go like it is going," the stock would be listed on the New York Stock Exchange. He stated that the United Nations was expected to approve the use of the pill in foreign countries; that the pill had been tested; and that it was unique, better than any other pill, and had no side effects.

Nassar further represented that Interamerican could produce "thousands and thousands of pills" in a week's time; that a factory would be established in Ireland which would turn out 100,000 pills a day; that Interamerican had a contract for the shipment of 1 million pills to South America; that the company's stock would be "comparable" to Syntex stock, then selling for around $90; and that Interamerican's pill was cheaper to make than that of Syntex.[5]

All of Nassar's statements were blatantly false or misleading. The pill had never been adequately tested.[6] It was commercially untried, virtually unprotected by patents, and could be legally sold only in Panama. Only one sale was ever made – 100,000 pills for $1,500.[7] And the United Nations had never expressed any interest in the pill.

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[5] Syntex Corporation is a prominent producer of oral contraceptives.

[6] It had been clinically tested for only three months on 60 women in Panama.

[7] The $1,500 purchase price was never paid.

Respondents do not challenge the fact that they made misrepresentations to customers. Rather, they assert that, in making those representations, Nassar relied on information furnished by Oscar Hausner, Interamerican's controlling person, and that Nassar was himself deceived by Hausner who was the architect of a fraudulent scheme to induce massive purchases of Interamerican stock.[8] But

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[8] As noted in our prior opinion, Hausner circulated misinformation about the effectiveness and potential sales of Interamerican's pill, the contracts for its distribution, and the United Nations' interest in it.

[9] In *Hanly v. S.E.C.*, 415 F.2d 589, 595-597 (C.A. 2, 1969) affirming our decision in *Richard J. Buck & Co.*, 43 S.E.C. 998 (1968), the court stated:

> "Brokers and salesmen are under a duty to investigate, and their violation of that duty brings them within the term 'willful' in the Exchange Act. Thus, a salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein.
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> ****
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> "In summary, the standards . . . are strict. He cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.
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> "*A salesman may not rely blindly upon the issuer for information concerning a company, although the degree*

Nassar's reliance on Hausner's self-serving statements was patently unwarranted. It fell far short of the stringent standards to which a professional in the securities business must adhere when he undertakes to recommend securities, particularly the unknown securities of an obscure issuer. In that situation, he is under a duty to make an adequate independent investigation to ensure that his representations have a reasonable basis.[9] This Nassar failed to do.[10]

Nassar was enthusiastically recommending the stock of a company that had no operating history and whose product was allegedly the result of a new scientific discovery. Yet he had no clinical data or scientific literature. Nor did he obtain any authoritative confirmation of the claimed properties of Interamerican's pill. Although economic factors were certainly important, he did not question the adequacy of Interamerican's resources to finance the manufacture and distribution of large numbers of pills, and he had no cost data of any sort. Moreover, he made no effort to confirm the United Nations' asserted interest in

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of independent investigation which must be made by a securities dealer will vary in each case. Securities issued by smaller companies of recent origin obviously require more thorough investigation." (Emphasis added.)

See also *M. G. Davis & Company, Inc.*, 44 S.E.C. 153, 157-158 (1970), *affirmed sub nom. Levine v. S.E.C.*, 436 F.2d 88 (C.A. 2, 1971); *John R. Brick*, Securities Exchange Act Release No. 11763 (October 24, 1975), 8 SEC Docket 240, 242.

10 Nassar's conversations with persons associataed with Hausner and with other brokers were clearly insufficient to satisfy his obligation to investigate. Nor can Nassar claim reliance on a deceptive report on Interamerican that was issued under the name of the brokerage firm of Dreyfus and Co. The report, dated May 11, 1967, did not appear until after respondents had already effected most of their Interamerican sales.

the pill. Nevertheless, Nassar made extravagant predictions as to the future price of Interamerican stock. As we have repeatedly held, it is inherently fraudulent to predict specific and substantial increases in the price of a speculative security.[11] Nassar cannot shift the blame for those predictions to Hausner.

It is clear that Nassar had no adequate basis for recommending Interamerican stock. And inforamtion he obtained from sources other than Hausner should have caused him to question the reliability of Hausner's representations. A chemist associated with Hausner testified that, in the course of numerous conversations with Nassar during the period February to April 1967, he advised Nassar that the pill was at a "premature" stage of development and that additional clinical work on it was necessary. Moreover, Nassar admittedly studied Interamerican's 1966 and 1967 annual reports. The 1966 report, which was the company's most recent for most of the period in question, stated that "no immediate benefit" could be expected from any of Interamerican's activities, and that the company's directors were "cautiously optimistic" that one or more of its ventures would be successfully developed "within the next two years."[12] While the 1967 report contained some optimistic statements,[13] it made it clear that tests

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11 See, e.g., *Alexander Reid & Co., Inc.*, 40 S.E.C. 986, 991 (1962); *Cortlandt Investing Corporation*, 44 S.E.C. 45, 50 (1969).

12 It further recited: "Negotiations are presently being carried on for the development and marketing in underdeveloped countries of the oral contraceptive drug, for the exploitation of the lumber rights and to encourage the development of the iron ore reserves."

13 It referred to tests indicating the pill's effectiveness, contracts for the distribution of the pill, and the expectation that facilities in Ireland for the production of over 2 million tablets per day would be available by the end of May 1967.

were still being conducted on the pill and that no sales had as yet been effected.[14] It also indicated that Interamerican had spent only about $27,000 for research and development.[15]

Both reports contained financial statements. But these consisted only of balance sheets and statements of deficit.[16] The bulk of the reported assets of about $1.6 million consisted of "investments." These were carried at some $1.4 million and represented the company's interests in Interamerican's subsidiaries, which were briefly described. But there was no meaningful breakdown showing how the underlying asset figures were derived.

No rational appraisal of Interamerican could be made on the basis of such sketchy materials.[17] Hence they did not provide an adequate basis for respondents' recommendations and representations.[18] Together with the information supplied by the chemist, they should have raised serious ques-

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[14] The report stated: "[I]t is expected that upon completion of clinical tests in the various areas indicated [Southeast Asia, Latin America and West Africa], [the birth control pill] will be approved for sale in such areas."

[15] The 1967 report listed a $27,099 asset item for "research and development." The 1966 report contained no such item.

[16] Both statements showed cumulative deficits of over $34,000.

[17] True, the financial statements in question were certified. But they were unconventionally fragmentary. They raised more questions than they answered.

[18] See *Cortlandt Investing Corporation*, 44 S.E.C. 45, 51-52 (1969); *Richard J. Buck & Co.*, 43 S.E.C. 998, 1009 (1968), *affirmed sub nom. Hanly v. S.E.C.*, 415 F.2d 589 (C.A. 2, 1969); *Crow, Brourman & Chatkin, Inc.*, 42 S.E.C. 938, 947-948 (1966); *Shearson, Hammill & Co.*, 42 S.E.C. 811, 830 (1965); *J. A. Winston & Co., Inc.*, 42 S.E.C. 62, 65-66 (1964).

tions in Nassar's mind about the statements being made by Hausner. Instead, Nassar repeated those statements to customers.

We again conclude that respondents willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.[19]

III.

In *Hochfelder*, the Supreme Court held that a private action for for damages would not lie under Section 10(b) and Rule 10b-5 in the absence of "scienter," which the Court defined as intent to deceive, manipulate or defraud.[20] In remanding this case, the Court of Appeals directed us to determine, in the first instance, "whether, after *Hochfelder*, some form of scienter must be established in an administrative enforcement proceeding under Section 10(b) and Rule 10b-5."[21] Unlike *Hochfelder*, this is not a private action for damages. It is a remedial proceeding instituted by a regulatory agency for the prophylactic purpose of protecting the public interest.[22] In light of that remedial

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[19] We find the evidence with respect to respondents' violations clear and convincing. We discuss below the question raised by the court as to what conduct of respondents violated Section 17(a).

[20] 425 U.S. at 193.

[21] 566 F.2d at 793.

[22] The Supreme Court in *Hochfelder* expressly declined to "consider . . . whether scienter is a necessary element in an action for injunctive relief under § 10(b) and Rule 10b-5." 425 U.S. at 194 n. 12.

objective, we think that *Hochfelder* is inapplicable to these proceedings and, therefore, that a finding of scienter is unnecessary to establish violations of Section 10(b) and Rule 10b-5.[23]

But assuming that *Hochfelder* applies to proceedings of this sort, we think that clear and convincing evidence establishes the requisite scienter on the part of respondents. Nassar points out that he purchased a substantial number of Interamerican shares based on Hausner's misrepresentations and suffered heavy losses on his purchases.[24] He argues that, even assuming that he was reckless in his dealings with customers, such conduct does not evidence the intent to deceive required by *Hochfelder*.

Hochfelder specifically left open the question of whether reckless conduct can satisfy the scienter requirement.[25] But, subsequently, several courts have answered that question in the affirmative.[26] And respondents were, at the

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[23] See *Steadman Security Corporation*, Securities Exchange Act Release No. 13695 (June 29, 1977), 12 SEC Docket 1041, 1050.

[24] It is axiomatic, of course, that Nassar's willingness to gamble with his own funds gave him no license to deceive others. See *A. T. Brod & Company*, 43 S.E.C. 289, 292 (1967); *Alfred Miller*, 43 S.E.C. 233, 238 (1966); *John R. Brick*, Securities Exchange Act Release No. 11763 (October 24, 1975), 8 SEC Docket 240, 246 n. 16.

[25] 425 U.S. at 194 n. 12.

[26] See *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 44 (C.A. 2, 1978); *Coleco Industries, Inc. v. Berman*, 567 F.2d 569, 574 (C.A. 3, 1977); *Wright v. Heizer Corporation*, 560 F.2d 236, 251-52 (C.A 7, 1977); *Sundstrand Corporation v. Sun Chemicql Corporation*, 553 F.2d 1033, 1039-40 (C.A. 7, 1977), *cert. denied*, 434 U.S. 875; *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (C.A. 5, 1977).

least, grossly reckless. They recommended and sold the securities of an obscure company on the basis of the auphoric representations made by Hausner and his associates.[27] Moreover, respondents carried on their sales campaign despite the receipt of information which should have dampened their enthusiasm and caused them to question the representations being made to them. Under the circumstances, we think it clear that respondents had the requisite scienter.

In any event, respondents violated Section 17(a) of the Securities Act to which *Hochfelder* does not apply.[28] The Court of Appeals noted that our prior opinion did not indicate "which behavior violated § 17(a) nor whether violations of § 17(a) alone would have sufficed to support Nassar's [sanction]."[29] We shall now clarify those issues.

All of our findings of fraud against respondents are made under Section 17(a) as well as under Section 10(b) of the Exchange Act and Rule 10b-5. Since all of respondents' actions violated Section 17(a), our findings under Section 10(b) and Rule 10b-5 are merely cumulative. Thus the sanctions we are imposing would be the same even if we made *no* findings under Section 10(b) and Rule 10b-5.

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[27] Hausner had no scientific or medical training or qualifications.

[28] Section 17(a) of the Securities Act makes it unlawful "(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

[29] 566 F.2d at 794.

The Supreme Court noted in *Hochfelder* that Section 17(a) was apparently the source of the language in Rule 10b-5 that on its face relates to behavior that does not involve scienter.[30] And at least two recent Court of Appeals decisions have recognized that scienter is unnecessary to establish a violation of Section 17(a),[31] a conclusion that is supported by the section's legislative history.[32]

IV.

Respondents argued that the sanctions we previously imposed are unduly severe. Nassar asserts that, during the period in question, he was a newly registered broker-dealer without much experience, that he was himself deceived by Hausner, and that he suffered heavy losses as a result. He further states that, during the lengthy interval between his asserted misconduct and our prior order herein, he complied with applicable requirements and no complaint was filed against him by any regulatory authority.

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[30] 425 U.S. at 212-214 and n. 32. The Court concluded, however, that "[Rule 10b-5's] scope cannot exceed the power granted the Commission by Congress under § 10(b)." *Id.* at 214.

[31] *S.E.C. v. Coven*, 581 F.2d 1020, 1025-1027 (C.A. 2, 1978); *S.E.C. v. World Radio Mission, Inc.*, 544 F.2d 535, 541 n. 10 (C.A. 1, 1976). See also *S.E.C. v. Van Horn*, 371 F.2d 181, 184-185 (C.A. 7, 1966).

[32] See *S.E.C. v. Coven, supra.* A contemporaneous comment on Section 17(a) states that the section "makes unlawful even innocent acts to obtain money or property by means of untrue statements of material facts or omissions to state material facts." Douglas and Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 181 (1933).

We have given careful consideration to all of the factors cited by respondents. But the violations we have found could hardly be more serious. We are dealing with a high-pressure sales effort, characterized by flamboyant representations and price predictions, which lacked any semblance of an adequate foundation. Nassar's reliance on Hausner affords no basis for leniency. We must protect the public not only from professionals in the business who practice deliberate deception, but also from those whose credulity and failure to investigate inflict equal harm on investors and undermine public confidence in the securities markets to the same extent.[33]

Respondents, citing our prior actions in *Carl M. Loeb, Rhoades & Co.*,[34] *J. H. Goddard and Co., Inc.*,[35] and *Strathmore Securities, Inc.*,[36] assert that we have assessed lesser sanctions for comparable misconduct. But the respondents in *Strathmore* who received light sanctions did not commit fraud. And our *Loeb, Rhoades* and *Goddard* orders were issued pursuant to offers of settlement. As we have repeatedly pointed out, in settlement cases we take into account pragmatic considerations such as the avoidance of time-and-manpower-consuming ad-

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[33] *Cf. S.E.C. v. World Radio Mission, Inc.*, 544 F.2d 535, 541 n. 10 (C.A. 1, 1976). In an injunctive action brought by this Commission, the court thought "it implausible to suppose that Congress intended to provide a mechanism for the S.E.C. to protect the public from the injurious schemes of those of evil intent and yet leave the public prey to the same conduct perpetrated by the careless or reckless."

[34] 38 S.E.C. 843 (1959).

[36] 43 S.E.C. 575 (1967).

versary proceedings.[37] Unlike the situation in those cases, we have before us a fully developed record. And it establishes serious and extensive violations of the securities laws. In cases comparable to this, we have discounted public interest factors of the type raised by respondents and imposed substantial sanctions for the protection of investors.[38]

Respondents' misconduct was egregious and protracted. It showed a marked insensitivity to the obligation of fair dealing borne by those in the securities business. The fact that after their misconduct respondents engaged in business without having further charges brought against them does not give rise to a presumption of good conduct on their part.[39] Indeed it appears that these proceedings did not sufficiently impress Nassar with the need to refrain from engaging in a repetition of his misconduct. In a 1976 proceeding based on the same violations,[40] Nassar testified with respect to his prior actions that he "was

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37 *Haight & Company, Inc.*, 44 S.E.C. 481, 512-13 (1971), *affirmed without opinion* (C.A.D.C., June 30, 1971); *Samuel H. Sloan*, Securities Exchange Act Release No. 11376 (April 28, 1975), 6 SEC Docket 772, 775 n. 24; *Gilbert F. Tuffli, Jr.*, Securities Exchange Act Release No. 12534 (June 10, 1976), 9 SEC Docket 839, 845 n. 46.

38 See, *e.g.*, *Alexander Reid & Co., Inc.*, 41 S.E.C. 372 (1963); *Robert Edelstein Co., Inc.*, 42 S.E.C. 257 (1964); *Alfred Miller*, 43 S.E.C. 233 (1966); *Richard N. Cea*, 44 S.E.C. 8 (1969).

39 *Cf. Russell L. Irish*, 42 S.E.C. 735, 743 (1965), *affirmed sub nom. Irish v. S.E.C.*, 367 F.2d 637 (C.A. 9, 1966).

40 Some months after we entered our order revoking registrant's broker-dealer registration and barring Nassar, the firm filed an application to become registered again as a broker-dealer. We then instituted new proceedings to determine whether to deny the application based on the violations we had found in this proceeding.

innocent then" and "would do the same thing now."[41] While we do not consider this testimony decisive, it is a factor that must be weighed in the balance.[42]

Our purpose here is not to punish respondents, but to protect the public interest from future harm at their hands. When we deal with the public interest requirements in a particular case, we must also weigh the effect of our decision on the welfare of investors as a class and on standards of conduct in the securities business generally. If these proceedings are to be truly remedial, they must have a deterrent effect not only on the respondents before us but also on others who may be tempted to recommend securities on the basis of unverified self-serving statements emanating from the issuer.[43]

We conclude that, under all the circumstances, the public interest requires the revocation of registrant's broker-dealer registration, registrant's expulsion from NASD membership, and a bar of Nassar from association with any broker or dealer. However, in view of the fact that this was Nassar's first offense, we shall permit him to

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41 Nassar argues that it is improper for us to take official notice of his sworn testimony in the denial proceedings. But we think it clear that we can take cognizance of that testimony. See *Shuttlesworth v. Birmingham*, 394 U.S. 147, 157 (1969). See also rule 14(d) of our Rules of Practice.

42 Cf. *S.E.C. v. First American Bank and Trust Company*, 481 F.2d 673, 682 (C.A. 8, 1973); *S.E.C. v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1101 (C.A. 2, 1972).

43 See *Arthur Lipper Corporation v. S.E.C.*, 547 F.2d 171, 184 (C.A. 2, 1976): "The purpose of such severe sanctions must be to demonstrate not only to petitioners but to others that the Commission will deal harshly with egregious cases."

apply after two years from the date of this opinion for permission to become associated with a broker or dealer.

An appropriate order will issue.

by the Commission (Chairman WILLIAMS and Commissioners LOOMIS and EVANS); Commissioners POLLACK and KARMEL not participating.

/s/ George A. Fitzsimmons

George A. Fitzsimmons
Secretary

[Seal of SEC]

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 15347 / November 22, 1978

Admin. Proc. File Nos. 3-1951 and 3-1952

In the Matter of

NASSAR AND COMPANY, INC.
301 Fifth Avenue Building
Pittsburgh, Pennsylvania
(8-12746)

GEORGE M. NASSAR

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that the registration of Nassar and Company, Inc. as a broker and dealer be, and it hereby is, revoked; and it is further

ORDERED that Nassar and Company, Inc. be, and it hereby is, expelled from membership in the National Association of Securities Dealers, Inc.; and it is further

ORDERED that George M. Nassar be, and he hereby is, barred from association with any broker or dealer with the provision that, after two years from the date hereof,

he may apply to the Commission for permission to become so associated.

By the Commission.

/s/ George A. Fitzsimmons
George A. Fitzsimmons
Secretary

[Seal of SEC]

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 78-2239 September Term, 1978

Nassar and Co., Inc. and George M. Nassar,
Petitioners

[Filed Dec. 28 1978]

v.

Securities and Exchange Commission,
Respondent

BEFORE: Bazelon, Leventhal and Robininson, Circuit Judges

ORDER

On consideration of petitioners' motion for stay of order of the Securities and Exchange Commission and of the memorandum of the Securities and Exchange Commission in opposition thereto, it is

ORDERED by the Court that petitioners' aforesaid motion for stay is denied.

Per Curiam

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 78-2239 September Term, 1978

Nassar and Co., Inc. and
George M. Nassar,
Petitioners

v.

Securities and Exchange
Commission,
Responent

BEFORE: Bazelon, Leventhal and Robinson, Circuit Judges

ORDER

On consideration of petition for reconsideration of motion for stay of an order of the Securities and Exchange Commission, it is

ORDERED by the Court that petitioners' aforesaid petition is denied.

Per Curiam

For the Court:

GEORGE A. FISHER, Clerk

By: /s/ Robert A. Bonner
Robert A. Bonner
Chief Deputy Clerk